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OUTLOOK

Traffic is Definitely on a Buyer's Mind

The slowdown in restaurant deal activity has generally been attributed to higher interest rates and bank liquidity problems, although with the supposed "dry powder" on the sidelines, you wonder why there weren't at least a few more deals in 2023.

In retrospect, deal scarcity had more to do with the fact that many QSR and casual dining brands had negative customer traffic in 2023. Sadly, both QSR traffic according to Revenue Management Solutions, and casual dining guest counts according to Knapp-Track, were negative during each month of the year.

How would negative traffic impact deal flow?

Well, imagine being a potential investor in a QSR or casual dining business and you see monthly year-over-year traffic declines. Then, you notice promotional activity ramped up in the second half of the year and you learned from the recent Restaurant Finance & Development Conference (RFDC) that sale multiples have yet to contract. Now you get the picture. No one wants to pay full price for a business that's losing customers.

We all know the task ahead for restaurant operators in 2024 is to build customer counts. That's a skill that's been ignored as operators dealt with a host of operational issues brought on by Covid. Covid provided cover to close dining rooms, eliminate value menus, cut labor, add surcharges, offer fewer menu options and stop introducing new products. Those are cost-saving actions, not sales-driving ones.

Once inflation began to run, operators relied on across-the-board price increases, ignored by consumers, at first, but frequent enough to eventually alter their buying behavior.

At RFDC, Deutsche Bank Analyst Lauren Silberman said menu prices have increased just over 20% over the past three years, or an average of around 7% per year. She pointed out the price increases were three times the pre-Covid average of roughly 2.5% per year.

"The menu price increases over the past three years should have taken the industry eight years," said Silberman.

Not surprisingly, that level of menu inflation has shocked restaurant goers. Consumer insight expert and former Brinker executive Lisa Miller surveyed 1,000 restaurant consumers for RFDC and found 59% of respondents said menu prices have gone up "too much." And, only 31% said the higher menu prices were "worth it."

In recent conference calls, the CEOs at McDonald's and Wendy's have lamented the fact their brands aren't doing as well with low-income consumers, which is another way of saying the value proposition is out of whack. According to R.J. Hottovy of Placer.ai, a software company that tracks foot traffic and provides location intelligence, some QSR consumers have traded down to discount grocery stores such as Aldi, or to dollar stores. I've been pointing out for years that C-stores are taking breakfast and lunch business away from QSRs.

Casual dining restaurant operators took the hint last fall that high prices are out of favor. Olive Garden's Never Ending Pasta Bowl was relaunched at $13.99. Applebee's rolled out their "Dollarita" again and is offering all-you-can-eat boneless wings, riblets and shrimp for $14.99. And, Chili's is promoting an all-day happy hour and a "3-for-Me" value meal that starts at $10.99. (Are these promotions or discounts?)

Analysts aren't predicting a very robust consumer in 2024 at any income level. "Resilient," is the description most of them use. Still, with improved margins and a benign outlook for food inflation this year, there's time to work on building guest traffic. What that takes is a different skillset, something called "Restaurant 101." That includes compelling marketing and promotions, clean restaurants with open dining rooms, accurate delivery and takeout orders, trained employees and even ones that smile once in awhile. That should pick up traffic and get the buyers circling once again.

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Auspex Capital Closes Sell-Side M&A Transactions

Financial advisory firm **Auspex Capital** has provided sell-side advisory on the following two transactions:

• **Vision Restaurants, Inc.** and **Mica Lands, LLC** (Vision), a Gainesville, Florida-based Taco Bell franchisee owned and operated by long-time quick service restaurant industry veteran **Nick Davis**, has completed the sale of its six Taco Bell restaurants and three fee properties to **US Leader Restaurants OpCo, LLC** and **Taco PropCo, LLC**. The restaurants are located in northern Florida and southern Georgia.

• **Three-M Associates, Inc.** is a LaVale, Maryland-based Arby's franchisee, owned and operated by long-time industry veteran **James Maltba**. Three-M has completed the sale of one high-volume Arby's restaurant, along with the underlying real estate, to **KBP Inspired, LLC** and its affiliated real estate holding company. KBP Inspired is an affiliated operating company under the umbrella of **KBP Brands**, a leading restaurant franchise group. With a widespread presence, KBP Brands oversees more than 800 stores across 48 states through its various affiliated operating entities.

For more information, contact Auspex Managing Director **Chris Kelleher** at 562-424-2455 or by email ckelleher@auspexcapital.com.

Kingbarn Realty Offers Capital and Development Services to Restaurants

Tony Hama has been developing restaurants for 15 years. Together with a development partner, "we have probably built 200 restaurants between the two of us," he said of his career before joining **Kingsbarn Realty Capital**.

It's one of the reasons he's leading the restaurant charge at Kingsbarn, Hama said. As managing director, he's responsible for sourcing, underwriting and executing Kingsbarn's ground-up development and infill redevelopment projects.

A deal they inked last year "will be a good launch pad for Kingsbarn to do more of these deals," he said. He's referring to Kingsbarn partnering with LVP Restaurant Group when they signed a deal to develop 20 Bojangles restaurants in Las Vegas. LVP Restaurant Group is part of LV Petroleum, which owns gas stations and c-stores. The group will develop 10 restaurants within its own TravelCenters America franchise locations, as well.

Hama was part of a group that flew to North Carolina to meet with Bojangles management, "and they liked our platform of bringing capital to projects, developing the real estate and then managing it."

Kingsbarn Realty Capital is a real estate private equity firm that provides structured real estate investments to high-net-worth individuals, family trusts, foundations and institutional investors. Hama said Kingsbarn is known as a leading DST (Delaware Statutory Trust) provider, and it is their core business. (Much like a 1031 exchange, DST investors own an interest in a property. The difference between the two is a DST trustee manages the property on the investors' behalf. With a 1031, investors own the property outright and must find a property management company to hire.)

"There are very specific guidelines on how they work, and we've been fully vetted and approved by the SEC and the IRS," he explained. "We have acquired over $2 billion in assets utilizing the DST."

Their approach is to provide turnkey real estate projects to their partners, like LVP, from site selection, design, permitting and construction management before turning over the keys to the operator. The operator will sign a long-term lease with Kingsbarn.

Kingsbarn Realty Capital started out as a real estate developer in 2019, but in order to diversify and take advantage of opportunities they saw in the marketplace, created a PE arm. Hama joined in 2020.

Their initial focus was multi-family development, but "as we started to become known in the marketplace for our development platform, we were approached by a number of operators to do the build-to-suit development. That's where the Bojangles relationship was born out of," he said.

Future restaurant work would depend on the strength of the brand and the operating partner, Hama said. "The reason Bojangles caught our attention was their ability to introduce a strong brand to the market, and we were impressed by the management team."

They are looking to work with franchisors or strong franchisees who have a multi-unit deal in a given market, rather than one-off deals. Kingsbarn has offices across the country, and Hama said they are not geographically constrained.

And, "We are open to participation on both the real estate and operations side," said Hama. "For the operator that may need additional working capital, we would consider making investments in the operating company on a case-by-case basis."

A point of differentiation

Hama explained they are unlike other developers, "as we are a vertically integrated private equity and development investment house. We are often our own exit strategy," he said. "We will build it and the DST will acquire what we are building."

For instance, the company is currently developing a number of TA truck stops, "with a couple hundred million in the pipeline," he said. Kingsbarn will be the buyer.

"We have the potential to create a longer-term relationship with our tenants. The relationship with the owner is

maintained, because we can stay with the ownership for the long term. That provides them with some comfort, knowing they won't have to deal with a new owner they haven't met before somewhere down the line." For more information, contact him at ahama@kingsbarn.com, or at (702) 553-9488.

Investment Banking Firm Moelis & Company Serves Broad Range of Restaurant Concepts

"Relationships don't happen overnight and it's important to develop them with companies before anyone else is calling them," said **Jeremy Burke**, executive director at **Moelis & Company**, a global investment banking firm with about 1,200 employees worldwide.

Burke leads Moelis' restaurant investment banking efforts providing M&A, capital markets and capital structure advisory solutions to companies in the sector. While most of his clients are large-scale, multi-unit restaurant operators, he enjoys developing relationships and working with up-and-coming emerging brands, too.

"I love working with founders," he said. "There's something special about advising a founder on one of the most important decisions of their lives."

Moelis has worked on a broad spectrum of restaurant transactions ranging from QSR, casual dining, fast casual, and non-traditional concepts like airport hospitality.

For example, they advised TAO Group on its reorganization and sale of a majority stake to The Madison Square Garden Company in 2017. At the time, TAO operated 19 entertainment dining and nightlife venues with recognized brands including TAO, Marquee, and Beauty & Essex. To bring things full circle, in 2023 Moelis advised Mohari Hospitality on its acquisition of TAO Group from Madison Square Garden, valuing TAO Group at $550 million.

Moelis served as financial advisor and placement agent to OTG Management on its $1.25 billion debt refinancing to further accelerate growth. OTG develops and operates restaurants and retail markets in airports throughout North America, with more than 350 locations.

Moelis also served as the M&A advisor to High Bluff and FS Investments, and exclusive placement agent to High Bluff on their acquisition of Church's Chicken in 2021.

Burke started with Moelis 10 years ago covering the gaming sector in New York and London, but over the last couple of years has transitioned his focus to restaurants. He noted, "In the restaurant sector, there is an overabundance of great companies, all with their own unique circumstances, looking for trusted, resourceful and quality strategic advice free from conflicts.

"The restaurant world has and will continue to see tremendous innovation," Burke said. "Tech, AI, and other innovations will completely enhance the economic model resulting in increased efficiencies. Despite rising buildout costs for most brands due to construction inflation, leveraging technology in various parts of the operating model should continue to enhance the economics of new store openings."

He's watching companies like 7 Brew, the drive-thru-only franchise coffee brand, and their innovation. "You pull up, and they come outside with an iPad to greet you. It's a modular building that costs less to build. They have increased both the customer and franchisee experience."

Legacy brands have been taking note of that innovation, too, he said. McDonald's recently opened their first CosMc's, a smaller-format location where customers can pick up coffee or a snack. "That's the direction things are going. You no longer need an acre for a buildout," he said.

A lot of new brands "are coming out of nowhere by continuing to innovate within existing categories," Burke said. "It's an exciting time for the industry. At the recent Restaurant Finance & Development Conference, we met with a number of innovative brands with explosive growth that frankly, we hadn't heard about 12 months ago." For more information, contact him at jeremy.burke@moelis.com, or at (212) 883-3872.

Unbridled Advises on Sale of Popeyes in Mississippi

Investment banking firm **Unbridled Capital** recently provided sell-side advisory services to **Russell Restaurants Group, Inc**, led by **Skip Russell**, on the sale of 13 Popeyes restaurants in Mississippi. The buyer was not disclosed.

Russell "is a first-generation franchisee who got his start in the Sonic business," said **Rick Ormsby**, managing director of Unbridled. "He worked for another owner and eventually became an owner. He built the business from scratch, and these were high-volume units."

In fact, Ormbsy said that the restaurants were "significantly above the national average in unit volumes. These were small-town, southern markets," he said.

In the Popeyes system, there are few mid-sized Popeyes packages available for acquisition, especially in those southern markets, Ormsby said. And, the brand "has had a resurgence over the last few years, and franchisees have been growing their unit counts. All of this catches the eyes of buyers."

As far as 2024 goes, "it's my sense that this year will indeed be stronger" for M&A activity, he said. "There's pent up demand."

In their business, Ormsby reported 2022 was down about 70% from 2021; 2023 was up over 2022 about 10- to 15%, "and my guess is 2024 will be an up year by about 10 or 15%." For more information, contact him at (502) 252-6422, or at rick@unbridledcapital.com.

Citizens Bank Releases 2024 M&A Report

Earlier this month, **Citizens Bank** released the results of its annual survey of 400 U.S. middle-market company CEOs, CFOs and private equity principals regarding their views on the M&A market in 2024. According to the report, the "annual survey reveals an optimistic outlook for mergers and acquistions in 2024."

Because this was a survey of executives from many industries, the Monitor called **David Stiles**, managing director with restaurant investment banking firm **Trinity Capital**, a division of Citizens Bank, to get his take on on where the restaurant industry will land, re: M&A.

"As long as the uncertainty that's been a challenge in the M&A environment abates, the M&A environment will improve and we are optimistic 2024 will see an increase in deal volume," Stiles said. But he thinks there are some "wild cards" still at play that may impact company performance, such as the consumer.

"While there are strong consumer reports and positive sentiment data out there, we also see both credit card and auto loan debt balances and delinquencies escalating to near or at record highs," he reported. And, "consumer savings is also near its lows. I think you need to monitor guest count carefully, particularly in those brands that offer the strongest value propositions and observe how these macroeconomic factors may play a role."

And, he added, if the Fed continues to lower rates, it could "give rise to more transactions. If inflation is finally under control and variability declines, we will see more consistent improvement in margins and with stronger trends in business performance, that welcomes stronger buyer interest. Still, when looking back at the halcyon days of 2021, I'm not sure we'll see that kind of activity again until the stars all align."

The survey also revealed the belief that 2024 will lean toward more of a buyer's market. Will that play out in the restaurant industry, as well?

"As far as buyers being in a position to dictate terms, it seems to me that is still the general feeling in the marketplace," he said. "However, that also depends on the quality of supply in deals that are in the market. There are still few quality restaurant transactions out there and for those deals, sellers are still in a position to drive terms. It's actually kind of balanced, in that regard."

He said he could see in 2024, that if operators continue to face certain pressures—consumer demand decline, margin compression and more—"leverage and cash flow becomes a real issue, there will be an increase in distressed deals, in which case, it will certainly be a buyer's market for those transactions. On the other hand, healthy transactions that are performing very strongly will still command premium valuation and take on characterizations of a seller's market. If operating challenges continue for those brands not getting their share of stomach space, I would expect this tale of two tales to play out. I think it is a little too early to predict either way because there are still too many moving pieces."

You can reach him at (310) 231-3110, or at david.stiles@citizensbank.com. Watch for the Citizens Trinity Restaurant, Franchise and Multi-Unit Report to be released later this month.

SouthState Bank Funds McDonald's Franchisee

SouthState Bank recently provided $13.8 million in conventional financing to a growing McDonald's franchisee in southern Georgia. The financing will be used for the acquisition of existing locations, remodeling and refinancing existing debt.

"This was my first McDonald's closing at SouthState," said **John Dutko**, SVP–franchise finance with the bank. In May, Dutko joined the franchise finance team from Truist, where he ran the nationwide McDonald's program there. Today, his goal is to build SouthState's McDonald's lending business and to make the bank one of McDonald's' approved national lenders.

Dutko has been financing McDonald's franchisees for years, and said consolidation is a trend, but not a new one.

"When I got into this business 12 years ago or so, the average McDonald's operator owned five locations," he said. "Today, that's pushing 10. 2021 was a high-water mark for acquisitions, just like in a lot of other concepts, and it's been slower since. But acquisitions will continue."

Dutko said they'll see an uptick in refinancings if rates go down substantially this year, too. "I think refinancings have been off the table for the last year or two, but that activity will speed up if they come down in a meaningful way," he said.

Also, "McDonald's will also go through phases of reinvestment" in their sites, Dutko added. "And right now, there is a lull. But they always come up with programs—a new equipment package, etc.—that will come up in a year or two and will require a round of reinvestment."

Since SouthState acquired Atlantic Capital Bank in 2022, the bank has been investing in growing the franchise finance platform, he said, and he'll also have the opportunity to work with other franchise concepts in his position.

"They have really put an emphasis on growing it. They liked what the franchise team had been doing," Dutko said. "I'm excited about the opportunity here. We're looking to grow and cement our team, and I feel like I'm in a good spot. I am feeling the room to run here." For more information, contact him at (404) 264-7969, or at john.dutko@southstatebank.com.

Some Key Follow-Up to Your COVID Relief Funds

By Dennis Monroe

The effects of the pandemic aren't over, so be aware of some of the current follow-up and ongoing issues associated with COVID Relief Programs. Erik Ordal of Myslajek Kemp & Spencer, whom I consider one of the top experts on the COVID Relief legislation, weighed in heavily on the issues for this article.

Restaurant Revitalization Funds (RRF): The RRF program provided funds that were mostly wide open, allowing restaurant owners to use them for a broad array of expenditures. The funds had to be used by March 11, 2023, and included a reporting requirement, which at this point is past due. We've had some indication from the SBA they are anxious to complete all filings, so if you haven't filed the appropriate reporting, do so now. The risk of non-reporting is the mandatory return of funds.

Employee Retention Credit (ERC): ERC seems to have a life of its own. Its deadline is quickly approaching and claims from 2020 quarters need to be filed by April 15, 2024.

Filing for 2021 quarters is April 15, 2025. There is no news currently on the IRS moratorium. You'll recall that in September the IRS stopped processing claims through 2023. Essentially, claims filed with the IRS from July on probably haven't been paid, which is unfortunate for legitimate claims (believe it or not, there are still businesses with unfiled ERC claims). Go ahead and send your filing to the IRS, but prepare for some type of new process and resubmission requirements. Bottom line is to treat it as if you are going to get the money back and cross your fingers Congress will act responsibly. Don't forget the tax implications for the ERC refundable tax credit, which requires the business to amend 2020 and 2021 returns to reduce wage deductions. This also applies to many state returns.

On another note, the IRS is going after what are known as "ERC mills" (you've probably seen the TV ads), and trying to claw back. To address the ERC mill concern, on December 21 the IRS set up a new voluntary disclosure program that lets those who received claims pay them back at a discounted rate of 80% of the refund with an interest break.

PPP payments: Hopefully most of you have had your PPP funds forgiven. For those who have converted unused portions to a note, make sure those loans are current and that you are adhering to all the requirements. I've been contacted by large, national operators who received IRS notices questioning the way they prepared their PPP applications and how they combined entities or didn't combine entities. I believe this is going to be an area that is subject to continuing audit.

Economic Injury Disaster Loans (EIDL): One of the largest areas of concern we have encountered, particularly in the M&A area, are EIDL loans. The requirements to obtain an EIDL loan were nonrestrictive, and there were 3.9 million EIDL loans made for a total of $38 billion. There has been sparse oversight on these loans and a lack of media attention. The deferral of payments turned from 12 months to 24 months and then 30 months, so EIDL loans in January 2021 didn't require any payments until this July. In most cases, the SBA filed a blanket lien, which you have to deal with for this filing. We have had a number of cases where the business assets or stock or membership interest are sold and the parties wanted to keep the EIDL loan in place due to its low interest rates. There is a consent process which is a fairly simple application allowing the loan to stay in place with the assumption by the new owners. The previous owners, however, are still liable for ongoing personal guaranty.

State Issues: Another major issue is, while the Federal Tax Law has been well defined as to forgiveness of PPP, RRF and tax return amendments for ERC, many states have not fully implemented Federal Compliance Legislation. So look for the updates for your state's legislation, and what will need to be done. Many tax practitioners have elected to file state returns as if Federal Compliance Legislation will be retroactively enacted.

What Else is Out There? Two other programs that deserve your attention are Pace Funds, which can be used particularly for energy-saving expenditures, frequently in hotel projects, and EB-5 investments to provide favorable equity for the restaurant industry in conjunction with securing a green card for the investor. Many states are still active in providing grants to the small-business community, so keep track of these.

And while you most likely wish you could wash your hands of the entire COVID nightmare, the effects, along with new strains, will be ongoing. So keep vigilant in both your business and personal hygiene.

Dennis Monroe is chair of Monroe Moxness Berg, a Minneapolis law firm which focuses on M&A, taxation, and other business matters for multi-unit restaurant businesses. You can reach him at (952) 885-5962, or by email at dmonroe@mmblawfirm.com.

Erik Ordal, a CPA with Myslajek Kemp & Spencer, Ltd. can be reached aterik.ordal@myslajek.com

Wall Street veteran and the Monitor's "Follow the Money" columnist **Roger Lipton** was a guest last week on economist **David Rosenberg's** "Webcast with Dave" podcast series. Lipton talked about the country's long-term economic outlook, the current bout with inflation and the impact of high interest rates on the U.S. budget deficit.

Franchise sales expert **Dan Rowe** is promoting franchises for **PayMore**, a retailer that allows individuals to sell new or used electronics for cash. During the past year, PayMore's store count has jumped from 27 to 181 locations.

Veteran restaurant broker **Ira Spilky** has 158 closed restaurants listed in and around Los Angeles ready to be converted into other concepts and available without the payment of "key money." Spilky told the Monitor the first quarter is always the busiest time for closures because of rent and minimum wage increases, underperforming locations and "hold outs after the holidays." He said the site quality of the closed restaurants is the best he's seen in 30 years. For more information, contact Ira Spilky at ira@iraspilky.com.

Business intelligence and consumer insight expert **Mac Brand** has published his latest book "Tending To Your Garden: Building and Sustaining Effective Business Relationships." Brand is host of the popular Brand Talk podcast in which he recently interviewed data science expert Mike Lukianoff. More info about Brand's book at www.macbrandbooks.com.

Surplus restaurant equipment specialist **TAGeX Brands** has added **Zach Sherman** to its management team as head of eCommerce. Sherman, an MBA grad from MIT, is the son of TAGeX CEO and founder **Neal Sherman**. Zach Sherman was previously a senior associate at Strategy&, a PWc unit, and spent three years at Caesars Entertainment.

This nugget was in a public relations release for **TGI Fridays** earlier this month announcing a massive store closure: "As part of the brand's ongoing growth strategy, TGI Fridays will also close 36 underperforming locations in select markets across the U.S." That's what you call putting a spin on bad news.

Overheard at the recent ICR conference in Orlando:

Red Robin CFO **Todd Wilson** said the company completed two sale-leaseback transactions in 2023 covering 18 locations and is close to another deal to sell and leaseback 11 additional properties. The first two transactions netted proceeds of $58.8 million at a cap rate of approximately 7%. Wilson said cap rates have moved higher since the last deal was completed and he now expects proceeds of $25 million to $26 million on the 11 properties.

Olo's chief revenue officer, **Diego Panama**, said there are now 78,000 restaurant locations on the Olo digital ordering platform, generating approximately $2,500 per location in revenue for the company.

The centralized kitchen is the key to the 130-unit **Salad & Go's** operating model which features a 48-oz, $7.00 salad served with scratch-prepared salad dressings. The company, run by restaurant industry veteran **Charlie Morrison** (Wingstop and Pie Five) consists of 130 stores (750 square foot average size) in Arizona, Texas, Oklahoma and Nevada, with plans to build more than a thousand units in the Southwest. Morrison said there are no plans to sell franchises.

Modern Restaurant Concepts CEO **John Cywinski** called **Qdoba**, his 750-unit brand, "a fly on an elephant's ass" when the Mexican chain was owned by **Jack in the Box** and then, private equity firm **Apollo**. But now Cywinski "hinted" the independent, 750-unit brand may go public as an investment alternative to Chipotle in the Mexican burrito category. Qdoba just completed a whole business securitization where it raised $305 million. Chain restaurant-level EBITDA is 18%, according to Cywinski, and there are 165 company stores. Don't be surprised if those company stores are refranchised soon. Cywinski said he wants "fewer, larger and more capitalized franchisees."

Donato's Pizza is back on track with a national franchise expansion program which began last year in addition to a growing presence in 274 **Red Robin** restaurants. With approximately 50 company stores and 127 traditional franchise locations, CEO **Tom Krouse** said the stores average $1.2 million and have average EBITDA of $150,000.

Chicken Salad Chick's average unit volume in 2023 was $1.5 million per store, up from $1 million in 2016. CEO **Scott Deviney** told an ICR audience the growing brand has 255 restaurants open in 18 states and should have 295 open by the end of 2024 with systemwide sales of $400 million. Deviney said the brand has potential for 2,000 units and is actively franchising. Chicken Salad Chick is owned by **Brentwood Associates**, which bought the brand in 2019.

Mums the word. **Burger King's** largest franchisee, **Carrols Restaurant Group** with 1,022 locations, met with institutional owners and the press last week at ICR, and kept their deal to be acquired by **Restaurant Brands International** top secret. RBI will pay $9.55 per share, or approximately $1 billion to buy back their largest franchisee.

A money manager at ICR reminded the Monitor that **Panera** was sold to **JAB** for $7.5 billion in 2017, approximately 18x its 2016 EBITDA. Panera at the time had 2,043 locations. The Mediterranean concept **CAVA**, on the other hand, has just 300 locations and is valued at $5 billion, which according to one Wall Street analyst, is roughly 50x its forward 2025 EBITDA. **Chipotle**, which CAVA is often compared to, has a market capitalization of $62 billion and operates 3,300 stores.

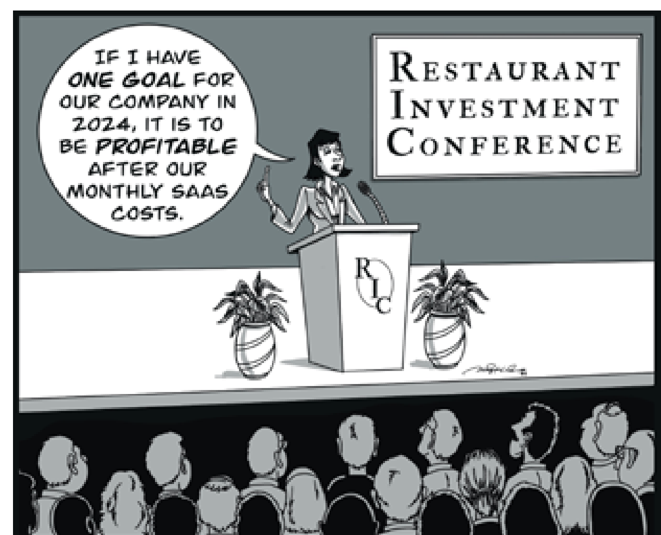
Changes are in store for **Papa Johns** franchisees. Franchisees were required to spend 8% of sales on marketing—5% for national marketing and 3% for local advertising. Now, the national marketing number will rise to 6%, but the franchisees will no longer be required to spend 2% on the local level. "Most national brands have moved away from the co-op and local marketing model for the productivity that is garnered by leveraging the national media platform," explained CEO **Rob Lynch** at the ICR conference. Also, to spur development, new **Papa Johns** stores will forgo paying into the national advertising fund during their first five years of a new agreement. One other change concerning Papa Johns franchisees: The company is gradually raising the revenue it receives from its supply chain which was fixed at 4% margin. Over a period of five years, the margin will be raised to 8%. According, to Lynch, that will cost franchisees approximately 1% of sales per year.

The IPO scuttlebutt at the ICR conference has **Panera**, **Cooper's Hawk Winery** and **Twin Peaks** as possible candidates as the markets improve, and has **Darden** acquiring **First Watch** sometime in late 2024.

Speaking of the breakfast and brunch restaurant chain, **First Watch's** announcement of an acquisition of their Raleigh franchisee, **VIM Holdings**, for $75 million turned a couple of heads at ICR. CEO **Chris Tomasso** explained this was the fourth acquisition of a franchisee group since May 2023. In October, the company acquired six franchised restaurants for $9.2 million. After these acquisitions, there are still nine franchisee groups left in the system, operating a total of 77 restaurants. First Watch hasn't franchised any new territories since 2017.

The 15-unit dining and entertainment concept, **Pinstripes Holdings**, merged with **Banyan Acquisition Corp.**, a special purpose acquisition company (SPAC) on December 29. Banyan had previously raised $253 million in January 2022 with the sale of shares and warrants at $10. However in April 2023, Banyan shareholders exercised their right to redeem their shares at a price of $10.42 per share. Each Pinstripe location ranges from 26,000 to 38,000 square feet and averaged $8.6 million in revenue for the fiscal year ended last April. New locations cost approximately $8 million. The company has funded its growth with equipment debt and tenant improvement allowances and just recently borrowed an additional $50 million from **Oaktree Capital Management** at an interest rate of 12.5%. Former McDonald's CEO **Jack Greenberg** is the company's lead independent director. Pinstripes management team will ring the opening bell on the New York Stock Exchange on January 19.

Portillo's stock hasn't performed well, other than a short-lived spike to $47 in November 2021, a month after its IPO. The stock now trades around $14 and to say there's been little excitement is an understatement. What's wrong? First of all, Portillo's has had trouble convincing investors that the concept works outside of Chicago, where it averages $11 million per store and has 30% margins. The stores in Arizona, Florida, and now Texas have all opened strong and the company points out that is where the future growth will be. The first Dallas location will do $13 million. However, the stores in Minnesota, Wisconsin, Indiana average around $6 million and the company's CFO, Michelle Hook, said they have 20% margins. That sounds pretty good, too, but, here's the problem: A new Portillo's costs $6.2 million to $6.5 million to build and that doesn't include land. The company says the cash-on-cash returns in year three are 25%, but that sounds risky when you consider the high cost to develop a new location. One mistake, and there go the earnings. The company is working on lowering the cost to develop new locations by around $1 million per store. At ICR this year, the company served attendees hot beef sandwiches and hot dogs from their food truck.



More on the U.S. Dollar, aka "The Reserve Currency"

The U.S. restaurant industry is increasingly influenced by hurricane-like macro headwinds. Previous generations of operators and investors could concentrate on local considerations, but not so today. Interest rates, money supply and consumer attitudes abroad, not to mention politics, influence an interconnected world. While all of us must survive in a short-term focused world, long-term economic trends cannot be ignored.

Here is what I believe are two incontrovertible economic principals being challenged today:

(1) Without a sound currency there cannot be a strong economy. If workers don't have confidence in the purchasing power of their labor they will work less.

(2) A huge debt burden reduces productive investment. A decade ago, Reinhoff and Rogart wrote "This Time is Different," and showed that government debt more than 90% of GDP (U.S. debt is now about 120%) suppresses economic growth. PHD economics aside, it stands to reason that anyone—a person, family, business or country—with an increasing debt burden is limiting more productive pursuits.

These two principals have been increasingly abused by governments worldwide over the last 100 years, with the USA leading the way with the excessive creation of our "reserve currency." There's never been a "fiat" currency that's survived. It's only a matter of time until politicians dilute it with base metals or excess supply.

Two thousand years ago, the Roman Empire collapsed (during the span of 350 years), with their gold and silver coins increasingly diluted with base metals. More recently the U.S., on a strict gold standard from 1790 to 1913, had roughly 4% real growth with minimal inflation. Unfortunately, the dominant dollar, managed by our Federal Reserve since 1913, accepted as the world's reserve currency since 1944, has been "abused" in the form of currency creation, especially in the last 20 years.

History shows that since the Roman Denarius, the French Franc, Dutch Guilder and Pound Sterling, have all had their turns as the world's "reserve currency." Those tenures lasted about 100 years. Our largest economic, political and military adversaries, China, Russia and Iran, are reducing the U.S. dollar's role, in their trade as well as foreign exchange reserves. Other central banks, watching the U.S. print unbacked currency since 2009, have been buying gold bullion in record amounts—1,000 tons in 2023—accounting for about 30% of worldwide production.

Modern macro concerns kicked off in August 1971, when Richard Nixon eliminated the exchange of dollars for gold. The closing of the gold window was necessary because almost two thirds of our gold (from over 20,000 tons to 8,400 tons) had been redeemed. Bankers knew the $35-per-ounce exchange rate was far too low. The country's post-WWII surpluses were in jeopardy from Lyndon Johnson's Great Society and the Vietnam War. A decade later Paul Volcker, backed by Ronald Reagan, was able to squeeze out the inflation of the 1970s, but the problems today, after adjusting for an economy six times as big, are a different order of magnitude. The total U.S. debt in 1981 was $1 trillion; now it is $34 trillion. The annual deficit then was $100 billion, now it is upward of $2 trillion. Today's unfunded entitlements—Social Security, Medicare and Medicaid—were hardly a problem. Now they are tens of trillions. The serious recession of 1980 to 1983 which corrected many of the "distortions" of the 1970s, would be dwarfed as a result of the necessary fiscal and monetary adjustments today.

Many are aware of the unsustainable fiscal and monetary path we are on, but the timing of the pain to come remains uncertain. I suggest the tipping point has arrived. The U.S. must refinance almost $1 trillion of debt monthly, at interest rates some 300-400 basis points higher than a year ago, so that interest expense is increasing $30 billion to $40 billion monthly and will be $360 billion to $480 billion more annually within a year. On a trailing 12-month basis, the current $650 billion interest expense will then be running $1 trillion or more, some 25% of the U.S. $4 trillion revenue base. History shows, including in Canada about 15 years ago, that interest expense around 30% "stops the music" in terms of bond market acceptance.

This is where the crystal ball gets cloudy. Nobody can predict what sort of governmental intervention will take place and how the consumer and economy will react. With regards to the two principles I opened with, I'm concerned about the future strength of our economy.

Back in the restaurant industry, the public needs to eat, but dining habits evolve. Prep time constraints dictate the location where the food will be prepared and discretionary funds affect the frequency of dining out. Overall, traffic remains challenged, especially Monday through Thursday, showing the effect of time and money constraints. Companies that can provide the hospitality culture as part of a dining experience will win the market share battle. I suggest that based on the discussion above, operators and lenders should be cautiously optimistic, at best.

Roger Lipton has followed the restaurant industry for four decades. Founder of money management and investment banking firm Lipton Financial Services, Inc., he publishes regularly at www.rogerlipton.com. He can be reached at lfsi@ aol.com or (646) 270-3127.

STATS AND QUOTES

MONITOR'S 2024 PREDICTIONS—TAKE THESE TO THE BANK!	
1.	A not-so-soft landing is still on the table as money remains tight, inflation sticky and consumer spending wobbles in the second half of the year.
2.	Expect an okay year for restaurants with improving store-level margins and flat traffic the new gold standard.
3.	2024 is a big promotion year as QSR and Big Pizza knock each other out trying to capture the lower-income consumers.
4.	Operators beware: Sales-leaseback providers now seek 8%-plus cap rates, which caps sales values and moves rents higher.
5.	Restaurant franchisees will accelerate non-restaurant franchise development (massage, wax, fitness) citing better unit economics.
6.	Franchisees favor high ROI and lower-risk remodels over new-unit development due to high construction costs.
7.	The Fed's telegraphed rate cuts will have little impact on restaurant borrowers who'll see higher interest expense and tighter scrutiny of their fixed charge coverage ratio from lenders.
8.	Labor is now the dominant portion of a restaurant's prime costs. Unfortunately, customers could care less about your labor costs, but they do know food. Price increases won't be automatic this year.
9.	The trillion dollars or so of institutional capital invested in private credit will find its way into franchisee restaurant businesses in 2024.
10.	Restaurant M&A advisors will be much busier in 2024 than 2023 as the spread between bid and ask narrows.

INTEREST RATES (%)

	01/12/24	Last Month	A Year Ago	Trend
Fed Funds Rate	5.50	5.50	4.50	↑
30-Day BSBY 1M*	5.35	5.43	4.39	↑
90-Day BSBY 3M*	5.40	5.52	4.71	↑
30-Day SOFR**	5.31	5.31	4.27	↑
90-Day SOFR**	5.31	5.31	4.27	↑
1-Year Treasury	4.69	4.96	4.71	↔
5-Year Treasury	3.83	4.00	3.60	↔
10-Year Treasury	3.94	4.04	3.50	↑
30-Year Treasury	4.18	4.18	3.61	↑
Prime Rate	8.50	8.50	7.50	↑

*Bloomberg Short Term Bank Yield Index **Secured Overnight Financing Rate

Perhaps the Federal Reserve won't cut interest rates as much as the market is expecting.

Ed Yardeni, President of Yardeni Research: "If the economy is doing reasonably well and inflation is coming down, the Fed isn't going to rush to lower interest rates—there isn't going to be any need for it. These are the kinds of rates that we had before the financial crisis, and the stock market did well, the economy did well. We're basically back to the old normal."

Oppenheimer's Chief Investment Strategist John Stoltzfus: "Our expectations are for the Fed to wait to cut its benchmark rate until at least the second half of next year and perhaps as late as the fourth quarter should inflation prove stickier."

Richmond Fed President Tom Barkin: "The FOMC's December meeting got a lot of attention. We acknowledged the progress on inflation and explicitly reaffirmed our willingness to hike if necessary. We also submitted our quarterly forecasts, which showed that FOMC participants expect inflation to settle without additional hikes. In that context—in which our forecasts are right and inflation does in fact continue to settle—most of us forecasted rate normalization to begin sometime this year. But the range of estimates was pretty wide, from no cuts to as many as six."

Ellen Zentner Morgan Stanley Chief U.S. Economist: "Investors betting that the U.S. Federal Reserve will begin trimming interest rates in the first quarter of 2024 may be in for a disappointment. After the Fed's December meeting, market expectations for a March rate cut jumped to surprising heights. Markets are currently putting a 75% chance, approximately, on rate cuts beginning in March. However, Morgan Stanley Research forecasts indicate that cuts are unlikely to come before June."

Restaurant Sales Growth May Be Sluggish This Year, Even in a Soft Landing (or Better) 2024

The good news for the restaurant industry is after recent benign government data releases including declining inflation readings and a strong GDP report for 3Q 2023 along with the encouraging year-end run up in the stock market, investors' baseline assumption for the economy is either a soft landing or no landing whatsoever in 2024. Most forecasters now believe the odds of a marked near-term slowdown in the economy are quite low. The less encouraging news is that several economic and demographic factors suggest that 2024 could be a challenging year for restaurants regardless of the expectations of equity analysts or economists.

• According to Moody's Analytics, Americans saved approximately $2.7 trillion during the pandemic from three rounds of stimulus checks, enhanced unemployment benefits, a 42-month pause in student loan repayments and from generally staying home over that period. The giant infusion of government assistance, coupled with the Fed's decision to dramatically increase the supply of money in the economy or M2, the Fed's estimate of the total U.S. money-supply money deposited in checking and savings accounts increased 40% from $15.5 trillion in early March 2020 to a peak of $21.7 trillion just two years later. It had some negative consequences, too: It caused inflation to spike in 2021 and 2022.

The $2.7 trillion of cash accumulation during the pandemic, which amounted to a remarkable $21,000 per U.S. household, has cushioned the blow of much higher inflation and interest rates. Indeed, about seven-in-10 Americans built some excess or emergency reserves during COVID, per a USA TODAY/Harris Poll survey conducted in September 2023.

However, data from that same survey show around six-in-10 Americans say they have already depleted most or all of these excess funds. Not surprisingly, 90% of respondents who claim much of the rainy-day money is gone either have already pared their spending or plan to do so.

• Statistics from the Bureau of Economic Analysis (BEA) seem to corroborate these survey results. In November, the personal savings rate in the U.S.—personal saving as a percentage of disposable personal income—was 4.1%. This rate represents a slight upturn from 4.0% and 3.8% readings in October and September, respectively, but is well below the average of about 9% over the last decade.

The marked decline in the savings rate of most Americans could be remedied by a sharp increase in income, which seems less likely given the anecdotal evidence of more widespread layoffs in a variety of industries, or through reduced discretionary spending. Of course, restaurants could be affected by any such pullback in spending.

Restaurants have enjoyed remarkably strong sales growth over the nine months ended November 30, 2023. Indeed, revenue at eating and drinking establishments has increased 8.5% year-over-year (YOY) over that span on a seasonally adjusted basis, according to the National Restaurant Association. In comparison, consumer spending at non-restaurant retail areas has grown at a much more subdued 1.7% pace over the past nine months. The rate of increase of consumer spending at restaurants seems likely to slow given the constraints on consumers' balance sheets outlined above. Moreover, the percentage gap between dollars spent at restaurants and in other retail areas seems almost certain to narrow as excess funds dwindle.

• Obviously, Americans with jobs are far more likely to be restaurant customers than those without steady paychecks, and demographic trends are working against restaurants as baby boomers, the largest generation in American history (76 million total births), are retiring, and Gen Z'ers (only 68 million total births) are entering the workforce. Simple mathematics dictates the number of Americans who are generally considered to be of working age (ages 15 to 64) is declining. Indeed, according to government data, the U.S. working age population totaled 207.4 million in 2022, down notably from 214.8 million in 2020.

• Both restaurant same-store sales (SSS) and traffic data seem to be confirming a sluggish overall restaurant growth forecast. According to the restaurant data analytics firm guestxm.com, year-over-year restaurant SSS increased 1.9% in November 2023. While modest, this gain did represent an upturn from 1.4% in October, and just above breakeven in September.

Traffic growth has remained consistently below SSS growth. The year-over-year change in restaurant traffic was negative 1.5% in November and negative 2.1% in October. Since April, almost all restaurant segments have experienced traffic contractions. Recent exceptions to this trend include the fast casual segment in November and fine dining in October.

A key reason for the improved sales and traffic figures in November from the prior few months was a moderation in the growth of the average check size. The bill in comparable restaurants increased only 3.5% year-over-year in November 2023, its smallest increase since December 2020.

Jim McFadden is a CFA and has 25 years of experience as a Wall Street analyst and portfolio manager.

TWAS THE YEAR TO BE A RESTAURANT INVESTOR			
Company/Symbol	**12/30/23 Price**	**2023 Change**	**Commentary**
Carrols Restaurant Group (TAST)	$7.88	479.4%	BKs comeback is real as its largest franchisee announced it would be acquired by Restaurant Brands International for $9.55 per share.
Red Robin (RRGB)	$12.47	123.5%	GJ Hart's North Star plan fired up investors in 2023, but now the heavy lifting begins for what most believe is still a troubled category.
Potbelly (PBPB)	$10.42	87.1%	A classic turnaround is underway with higher average weekly sales. Now it's time to take the company private.
Wingstop (WING)	$256.58	86.4%	As an industry leader, up-and-coming restaurant chains will soon talk about themselves as being the "next Wingstop."
Shake Shack (SHAK)	$74.12	78.5%	As Shake Shack expands outside of the northeast, it will find its menu too expensive versus Culver's, Freddy's and Whataburger.
Chipotle (CMG)	$2,286.96	64.8%	Chipotle is one of the most amazing cash cows in restaurant history. Value, loyalty, take-out and $1.5 billion in cash.
Kura Sushi (KRUS)	$76.00	59.4%	Trading at almost 30x 2025 EBITDA, Kura Sushi has to open a lot of stores and sell a lot of spicy tuna rolls to justify that valuation.
Dave & Buster's (NDLS)	$53.85	51.9%	Our columnist Roger Lipton says this is one to own in 2024, trading at roughly 6x EBITDA.
First Watch Rest Group (FWRG)	$20.10	48.6%	Great performance in 2023 when you consider its PE sponsor—Advent International—takes every opportunity to dribble out stock.
Krispy Kreme (DNUT)	$15.09	46.2%	Hard to get excited about a hub-to-spoke business with a fat $2.5 billion valuation that distributes donuts to C-stores.
Bloomin' Brands (BLMN)	$28.15	39.9%	When an activist shoots off their mouth about how much they know about running restaurants, it's time to take profits and skedaddle.
BJ's Restaurants (BJRI)	$36.01	36.5%	BJ's is valued at about 50% of annualized revenues and trades at around 6.5-7.0x EBITDA, which means it deserves a second look.
Brinker International (EAT)	$43.18	35.3%	Advertising restaurants on television was the best way to reach the greatest generation and boomers, and Brinker has brought it back.
Chuy's (CHUY)	$38.23	35.1%	Steady Eddie Mexican dinnerhouse chain trades at 8x EBITDA and generates nice cash flow. A dividend would sure be nice.
Texas Roadhouse (TXRH)	$122.23	34.4%	This casual dining brand keeps the sales up and the customers happy, even if it costs them a few margin points.
Sweetgreen (SG)	$11.30	31.9%	Fortunately, the company has $275 million in cash, especially when you consider losing operations and a 23% G&A number.
Fat Brands (FAT)	$6.06	22.4%	The key here is whether Fat Brands can IPO Twin Peaks this year and pay down some of that gargantuan $1 billion debt.
Restaurant Brands Intl (QSR)	$78.13	20.8%	Burger King and Popeyes have the best chance to recapture the low-income consumer who has been abandoned by other QSRs.
Jack in the Box (JACK)	$81.63	19.6%	With California's wage about to go to $20 per hour in April, no wonder officials were touting the asset-lite model at ICR.
Domino's Pizza (DPZ)	$412.23	19.0%	Shares are up 17% since the Uber Eats partnership was announced. What if this destroys DPZ's reputation for speed and value? Eh!
Darden Restaurants (DRI)	$164.30	18.8%	With Gene Lee now retired, at least one of the 22 analysts who jump on the DRI call should be nervous about when the shoe drops.

Continued from Page One

More Problems on Main Street

I wrote previously about a Covid-era lending program known as the Main Street Lending Program (MSLP), which was designed to assist midsize companies and small businesses survive the pandemic. Loan proceeds under the MSLP were advanced 95% by the Federal Reserve of Boston and 5% by a bank, with both parties serving as co-lenders.

Unlike Payroll Protection Program loans, Main Street loans were full-recourse and not forgivable. According to Treasury Department data, 319 banks issued 1,830 Main Street loans for a total of $17.5 billion until the program was terminated in 2021. Of those loans, $2.3 billion have now been identified by the Special Inspector General for Pandemic Recovery under the Treasury Department as either having defaults, delinquent interest payments, delinquent financials, impaired loans or material misrepresentation.

One of the most aggressive lenders in MSLP loans was City National Bank of Florida, which funded $2.2 billion in loans, approximately 12% of the total MSLP loans originated nationally. A number of City National's loans were made to restaurant companies, including one for $49.7 million made in 2020 to entities owned by Starboard Companies, a multi-unit franchisee of Wendy's controlled by investor Andrew Levy. Levy used the MSLP to refinance an outstanding debt owed to Fifth Third Bank on approximately 70 Wendy's.

In 2017, Levy's company was ranked by the Monitor as the 32nd largest franchisee in the U.S. operating over 185 Wendy's, but Levy sold many of them over the next four years as he encountered financial troubles related to the brand's CAPx requirements. On November 14, Levy put the Starboard entities, consisting of 61 remaining Wendy's units, into Chapter 11. In the filing, Levy said the company anticipates "potentially closing additional underperforming stores, or stores with large remaining remodel obligations." Wendy's is owed $1.4 million, according to the filing.

—John Hamburger

Join us for two weeks of informative webinars on Franchising and Restaurant Real Estate!

Franchise Times magazine and the Monitor are producing a series of webinars on franchising and restaurant real estate. **Franchise Times Outlook 2024** is scheduled for January 29-February 1 and the Monitor's **Restaurant Real Estate Series** will run February 26-29. Here's what's on tap for each:

Franchise Times Outlook 2024—This webinar series is geared for franchisors, franchisees and those in franchising and covers a range of topics including the state of franchise finance, franchise sales tactics, legal trends and legislation impacting franchising, tax and accounting tips geared especially for franchise owners. There is also a franchise CEO panel featuring **Rick Silva**, CEO, Culver's; **Shauna Smith**, CEO, Savory Restaurant Fund; and **Neil Gill**, CEO, Dogtopia. Other prominent speakers in this series include **Cristin O'Hara**, Managing Director, Restaurant Group Head, Bank of America; **Jeff Poe**, Managing Director, Fifth Third Bank; **Dan Holland**, EVP of Restaurant Banking, Cadence Bank; **Mike Rozman**, CEO, Boefly; **Brad Cashman**, Principal, Monroe Moxness Berg; and **Jeremy Hirsch**, Senior Vice President, Houlihan Lokey.

Register now for this webinar series by going to www.franchisetimes.com.

Restaurant Real Estate Series—This webinar series produced by the Monitor consists of four sessions that will introduce you to important leasing guidelines and provide you with tips on how to effectively negotiate and renegotiate a restaurant lease and how to manage a large-scale real estate workout. We assembled an outstanding group of property experts including **Lewis Gelmon**, Acuity North America; **David Ahn**, CRE Companies; **Bobby Palta**, Leasecake; **Navin Nagrani**, Hilco Real Estate; and **Joe McKeska**, A&G Real Estate Partners.

Monitor subscribers and past RFDC attendees will receive an email link in early February to register for this webinar series.

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John M. Hamburger (jhamburger@restfinance.com) • Mary Jo Larson (mlarson@franchisetimes.com)

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TO SUBSCRIBE CALL (800) 528-3296 FAX (612) 767-3230 www.restfinance.com